



Circle Energy  
Inc.

## 1996 ANNUAL REPORT

### *President's Message*

*Management's focus in 1996 was to build an exceptional base of assets to dramatically impact shareholder value. We now have five major core assets, each of which has the potential to be a "company maker."*

- *60,000 net acres supported by extensive seismic and technical data.*
- *Offsetting lands with proven production.*
- *The diversified nature of our assets includes a mix of exploration and development drilling opportunities—heavy oil, oil and gas.*
- *We are the Operator of all assets and, therefore, control drilling schedules.*
- *Our outstanding management group is supported by the best technical expertise in the industry.*

*Financing is underway to begin an aggressive drilling program that includes two wells at Brazeau River, Alberta, targeting several highly prospective pay zones; a 100% owned reef prospect in central Alberta; and a Bounty, New Mexico well. In addition, our 40,000 net acres in New Mexico supports significant development.*

*On behalf of Circle's Board of Directors and management, I thank you for your support this past year and we look forward to a rewarding 1997.*

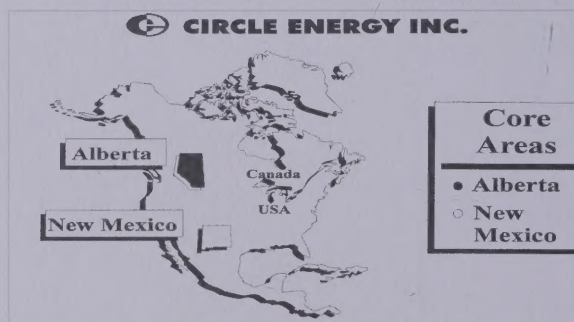
*C.W. (Bill) Baker  
President*

**Circle Energy  
Inc. (CEN)**

**1996 Annual Report**

**Symbolic  
Meaning  
of the Circle**

The circle is a powerful symbol. In nature, the sun, moon and earth are all symbolized using the circle. The circle is also a symbol of integrity, strength, commitment and endurance. At Circle Energy, we continue to evolve our company on these principles.



**Company  
Profile**

Established in 1994 as a junior capital pool, Circle Energy is focusing on two core areas: Alberta and New Mexico. We have over 60,000 net acres supported by extensive seismic and technical data. Circle Energy is now positioned to capitalize on the outstanding underlying value that has been created.

**Table of  
Contents**

President's Message to Shareholders .....	Cover Page
Asset Profile: Alberta .....	3
Asset Profile: New Mexico .....	6
Financial Overview .....	10
Audited Financial Statements .....	11

**Notice of  
Annual  
Meeting**

The annual meeting of the shareholders of Circle Energy Inc. will be held Thursday, June 19, 1997, at 10:00 a.m. in the Royal Room, 2nd floor, Metropolitan Centre, 333 4th Ave. S.W., Calgary, Alberta. If unable to attend, registered shareholders are invited to complete and return the enclosed proxy form.



## Asset Profile: Alberta

### Brazeau River

## Superior Drilling Opportunities

### Definitions:

- mmcf/d: one million cubic feet of gas per day.
- boe: barrels of oil equivalent (10 mcf = 1 boe).
- NGLs: natural gas liquids.

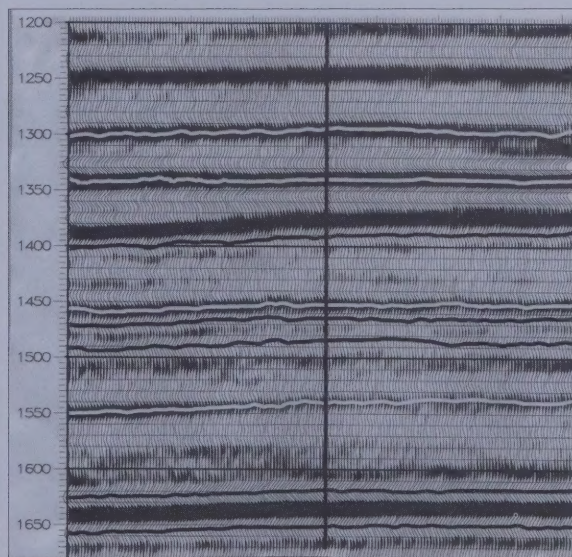
### Shunda Prospect:

- 60% working interest before payout (45% after payout).
- Six highly prospective, seismically mappable zones overlie the Nisku; each is capable of producing 2 to 10 mmcf/d (200 to 1,000 boed).
- The Brazeau region was featured as one of three "hot play" areas in Alberta in 1996. (See *Nickle's Petroleum Explorer*, Hot Plays of 1996, February 1997 edition).

Overlying the Nisku are six highly prospective uphole zones. They include the Viking, Glauconite, Ostracod, Rock Creek, Nordegg and Shunda. Offsetting wells that produce from these horizons are capable of producing between 2 to 10 mmcf/d of gas (200 to 1,000 boed) with reserves ranging from 2 to 15 billion cubic feet per zone. CEN's first well will be drilled in July, 1997.

### Brazeau River Cross Section

Seven prospective zones are shown in this Brazeau seismic cross section.



**Asset Profile:  
Alberta**

**Brazeau River**

**Definitions:**

- blow down: recovery of dry gas after NGLs have been removed.
- bcf: billion cubic feet.
- mmbbls: million barrels.

**Nisku Prospect:**

- 75% working interest before payout (52.5% after payout).
- Offsetting well (Nisku "P" pool) is producing 3200 bbls of NGLs.
- Reasonable forecast of 2500 bbls of NGLs per day. Blow down is estimated to begin in 2001 at a rate of 10 mmcf (1,000 boed) per day.
- Nisku "P" pool assigned 400 bcf of gas and 42 mmbbls of oil.

The Nisku "P" pool produces sour gas and Natural Gas Liquids (NGLs) from the Nisku carbonate shelf reservoir. The pool has an areal extent of approximately 16 sections and is currently under a gas recycling program. The liquids are removed and dry gas is reinjected into the pool. Gas production will begin in 2001. Existing well control and proprietary seismic data indicate reservoir thickening towards the northeast end of the pool which includes Circle's land. The closest offsetting well is producing approximately 3200 barrels of NGLs/day. Circle believes a reasonable forecast for a Nisku well would produce approximately 10 mmcf (1000 boed) of gas after 2001. A Nisku well will also be drilled in 1997.

**Nisku "P" Unit  
Net Gas Pay  
Metres**

**Average Daily**

**Well Production:**

- 16 mmcf raw gas
- 2500 bbls NGLs

**CEN's Anticipated**

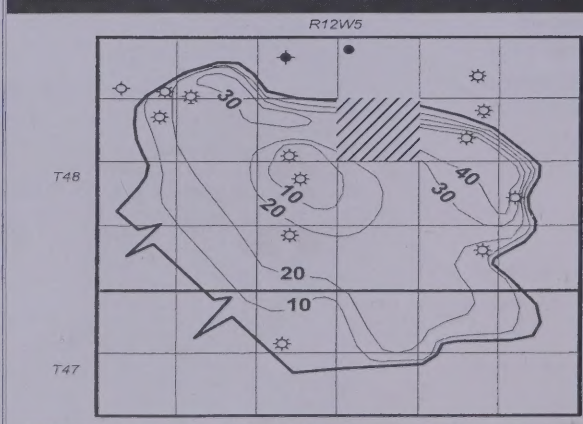
**Net Reserves:**

- 2.5 mmbbls NGLs
- 35 bcf raw gas



**CEN Land**

**Nisku "P" Unit - Alberta**





**Asset Profile:  
Alberta**

**Waskatenau**

**Multi-well Drilling Opportunities for  
Reef Prospects**

**Definitions:**

- boed: barrels of oil equivalent per day.
- farm out: when one company allows another to "farm in" on its lease.
- farm in: when one company drills a well(s) on another company's lease to earn an interest in the lease or the well.

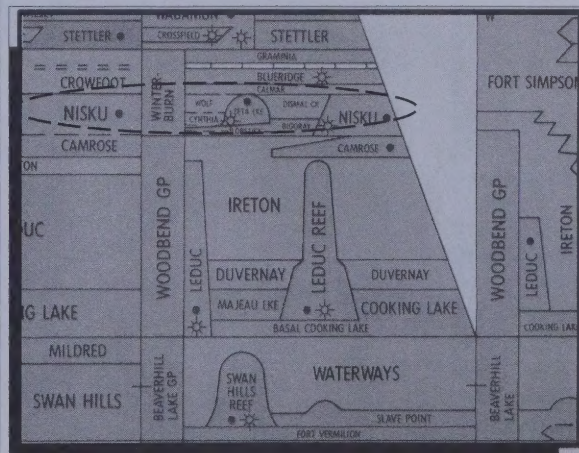
- 100% ownership of 6,000 net acres at excellent addresses.
- Multi-zone drilling target increases upside potential.
- Production potential up to 1,000 boed.
- Seismically defined drilling location has been identified.
- 1,200 metre reef target - low drilling costs.
- First well scheduled for third quarter, 1997.

CEN continues to hunt for reefs in the Waskatenau area where Devonian reefs are found at shallow depths and can produce in the range of 200 to more than 1,000 boed. CEN has leading edge seismo-geological support to maximize our potential for success.

Circle has now finalized one drilling location targeting a Devonian reef and has identified several other leads. The first well is scheduled for the third quarter, 1997. Our 100% land position gives CEN the option to farm out this high potential prospect while maintaining the opportunity to create outstanding shareholder value.

**Nisku Cross  
Section**

The Nisku target is defined in the upper quadrant of this illustration.



**Asset Profile:  
New Mexico**

**Alysham**

**Great Exploration Play**

**Definitions:**

- boe: barrels of oil equivalent (10 mcf = 1 boe).
- bbls: barrels of oil.

- 100% ownership of 24,000 net acres.
- 100 miles of proprietary seismic identifies approximately 20 separate structures including two potential reef anomalies at 3,000 feet.
- Independent engineer has assigned existing wellbore over 700,000 boe (Granite Wash zone only).
- Cash flow estimated at \$120 million over life of reservoir based on one section in 10 being productive.

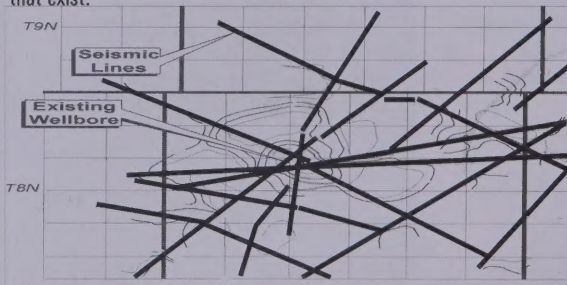
The Alysham project's seismo-geological information and reprocessed seismic data indicates there are approximately 20 prospects and leads including two potential reef anomalies at approximately 3,000 feet. A wildcat test well drilled at Alysham in the early 1980's indicated significant hydrocarbons in several geological horizons. Due to the downturn in the industry, the well was abandoned. However, based on existing logs and well information, an independent engineering firm has assigned more than 700,000 bbls of reserves per 160 acres.

We believe the Alysham project is analagous to the Granite Wash pools of the Potter Field in west Texas. Using this analogy, if one section in 10 produces 3 million bbls of oil, the entire 40 sections are capable of producing 12 million bbls, giving Alysham the potential to deliver \$120 million in cash flow over the next several years.

Utilizing under balanced drilling and horizontal drilling technology, CEN is positioned to capitalize on the tremendous exploration opportunities that exist.

**Alysham Project Area**

Existing wellbore and seismic lines of the Granite Wash structure.



**Asset Profile:  
New Mexico**

**Newkirk**

**Heavy Oil Technology Makes the Difference**

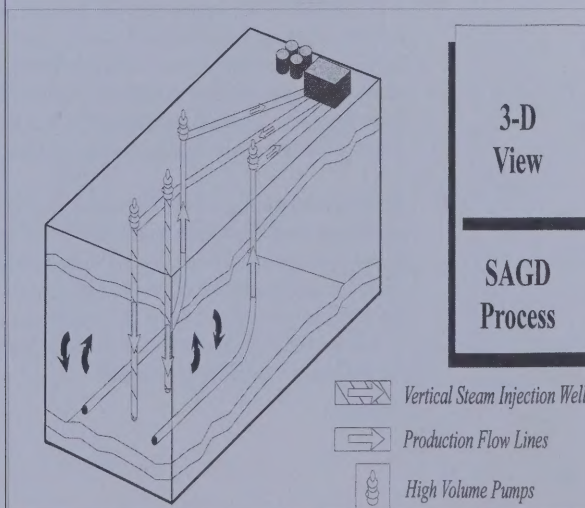
- 50% ownership of 4,000 net acres.
- Government/industry reports indicate 37 to 60 million barrels in place. Long life reserves.
- New technologies significantly enhance this project.
- Asset close to highway and rail lines.

The Newkirk pool contains an estimated 37 to 60 million barrels of oil in place. Despite good reservoir properties, the economic situation and the lack of sophisticated technologies in the early 1980's prevented the successful development of this asset.

New technologies in the exploitation of medium/heavy oil production have encouraged Circle to re-assess Newkirk's potential. Reservoir analysis by the Petroleum Research Institute and industry experts continue to demonstrate the potential of this project.

CEN will proceed with a 3-D seismic program to identify "sweet" spots within the pool followed by a pilot drilling project in 1998.

**New  
technologies  
expand  
opportunities  
for Newkirk**





**Asset Profile:  
New Mexico**

**Bounty**

**Proven Reserves**

**Definitions:**

- mmcf: million cubic feet of gas.
- bbls: barrels of oil.

- 100% ownership of 14,000 net acres.
- Proven reserves with multi-zone potential.
- Oil target with significant gas potential.
- Extensive log and drilling information.

This highly prospective project is 12 miles south of Circle's Newkirk heavy oil project. Several pipelines run a few miles north of the project.

Bounty is the most advanced of the three New Mexico projects due to the availability of extensive historical drilling information acquired by Circle in the past year. A well drilled in 1982 to test the Pennsylvanian aged Atoka zone had a drill stem test rate of 2.7 mmcf per day of natural gas and produced approximately 50 bbls of condensate. Additional wells were drilled with similar results including excellent oil shows in several zones. The average thickness of the Atoka in these wells is 800 to 1,000 feet.

In 1983, the Operator received permission from the State to proceed with an enhanced oil recovery program. The plan, which was developed with the Petroleum Research and Recovery branch at the University of Soccero, was to reinject gas into the upper Atoka and produce oil from below it. However, the project was abandoned in 1984 during the downturn in the oil and gas industry both due to economic and technical problems. The enhanced recovery program was never implemented.

Circle's management and consultants have reviewed extensive technical information and interviewed state technical staff and the well's Operator. We have concluded that the wells were seriously damaged during the drilling and testing process and were perforated, in at least one instance, eight feet off depth. An experienced drilling team using underbalanced drilling and horizontal drilling technology would minimize risk and maximize production potential.

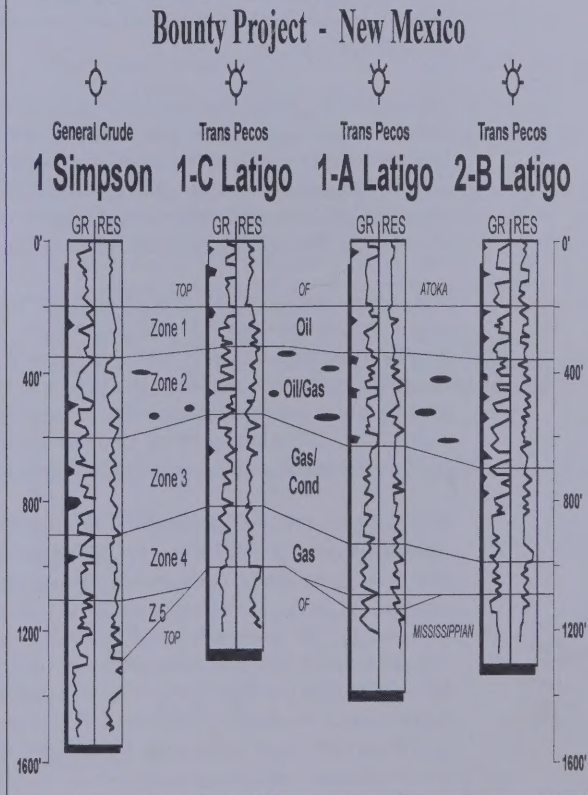


**Asset Profile:  
New Mexico**

**Bounty**

Circle is now proceeding with licensing a well which will offset one of the previously drilled wells and our first significant target will be light oil in the San Andres zone at a depth of 2,600 feet. The Atoka zone has proven reserves including outstanding gas and condensate potential. We are working with various groups in New Mexico to develop a gas marketing strategy.

**Bounty Cross  
Section:  
illustrating  
multi-zone  
potential.**



## Financial Review

Revenue for 1996 amounted to \$342,167 compared to \$749,131 in 1995. Lower revenue was due to the sale of producing properties effective April 1, 1996 offset by reduced royalties, management fees earned in 1996 and interest revenue in 1996. Total expenses for 1996 were \$485,145 lower than in 1995 resulting in a before tax loss of \$83,100 before the gain on disposal of capital assets and before the write-off of capital assets compared to a loss of \$161,281 in 1995. Lower total expense is the result of lower operating expense and lower depletion, depreciation and amortization due to the sale of producing properties, lower interest expense due to repayment of debt, offset in part by higher general and administrative expense. General and administrative expense increased in 1996 due to a higher level of corporate activity resulting in higher travel, business promotion and investor communication expenses.

Effective April 1, 1996, the Company sold all of its producing petroleum and natural gas properties resulting in a gain on disposal of \$393,090. During 1996 the Company abandoned an exploration well and impaired certain exploration properties resulting in a write-off of \$459,376. After taking into account the gain on disposal and the write-off, the before tax loss for 1996 was \$149,386 compared to a loss of \$161,281 in 1995.

Funds used in operations during 1996 amounted to \$33,413 compared to funds provided by operations of \$5,725 in 1995. During 1996 the Company completed two private placements raising gross proceeds of \$1,093,000. Proceeds from the private placements and proceeds from the sale of producing properties have been used in 1996 to repay \$822,000 debt and to finance \$975,909 cost incurred for the acquisition and exploration of petroleum and natural gas properties in Central Alberta and New Mexico.

At December 31, 1996 the Company had no debt and \$326,939 cash. Current assets amounted to \$371,469 at year end 1996 compared to \$61,953 in 1995, primarily the result of increased cash due to proceeds of the private placement and the sale of producing properties. Current liabilities at year end 1996 were \$32,850 compared to \$955,024 in 1995. The substantial reduction in current liabilities is primarily due to the repayment of \$822,000 debt in 1996 which was accounted for as a current liability at year end 1995. Capital assets at December 31, 1996 were \$462,793 compared to \$917,056 for year end 1995. Lower capital assets in 1996 were primarily due to the write-off of certain exploration properties amounting to \$459,376.

## Financial Review

KPMG  
Chartered Accountants

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### AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Circle Energy Inc. as at December 31, 1996 and 1995 and the statements of loss and deficit and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG

Chartered Accountants

Calgary, Canada  
March 27, 1997





**Audited  
Financial  
Statements**

**CIRCLE ENERGY INC.**

Consolidated Balance Sheets

December 31, 1996 and 1995


	1996	1995
<b>Assets</b>		
Current assets:		
Cash	\$ 326,939	\$ 20,204
Accounts receivable	39,162	41,749
Prepaid expenses	5,368	-
	371,469	61,953
Capital assets (note 2)	462,793	917,056
Deferred financing costs	-	8,837
	\$ 834,262	\$ 987,846

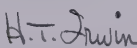
**Liabilities, Capital and Deficit**

Current liabilities:		
Accounts payable and accrued liabilities	\$ 32,850	\$ 117,024
Income taxes payable	-	16,000
Loan payable	-	822,000
	32,850	955,024
Provision for site restoration	-	49,902
Deferred income taxes	-	16,000
Share capital and deficit:		
Share capital (note 3)	1,217,370	250,900
Deficit	(415,958)	(283,980)
	801,412	(33,080)
Commitments (note 6)		
	\$ 834,262	\$ 987,846

See accompanying notes to consolidated financial statements.

On behalf of the Board:

 Director

 Director

**Audited  
Financial  
Statements**

**CIRCLE ENERGY INC.**

Consolidated Statements of Loss and Deficit

Years ended December 31, 1996 and 1995

	1996	1995
Revenue:		
Oil sales	\$ 257,562	\$ 1,052,396
Royalties	(75,749)	(303,265)
Consulting and other income	160,354	-
	342,167	749,131
Expenses:		
Operating	57,485	452,557
General and administrative	286,954	224,396
Interest	32,549	50,453
Depletion, depreciation and amortization	48,279	157,611
Provision for site restoration	-	25,395
	425,267	910,412
Loss before undernoted	(83,100)	(161,281)
Gain on disposal of capital assets	393,090	-
Write-off of capital assets	(459,376)	-
Loss before income taxes	(149,386)	(161,281)
Income taxes (note 4):		
Current (recovery)	(1,408)	16,000
Deferred (reduction)	(16,000)	16,000
	(17,408)	32,000
Loss for the year	(131,978)	(193,281)
Deficit, beginning of year	(283,980)	(90,699)
Deficit, end of year	\$ (415,958)	\$ (283,980)

See accompanying notes to consolidated financial statements.

**Audited  
Financial  
Statements**

**CIRCLE ENERGY INC.**

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1996 and 1995

	1996	1995
Cash provided by (used in):		
Operations:		
Loss for the year	\$ (131,978)	\$ (193,281)
Items not involving cash:		
Depletion and depreciation	39,442	141,571
Provision for site restoration	-	25,395
Amortization of deferred financing costs	8,837	16,040
Deferred income taxes	(16,000)	16,000
Gain on disposal of assets	(393,090)	-
Write-off of capital assets	459,376	-
Funds provided by operations	(33,413)	5,725
Change in non-cash operating working capital:		
Accounts receivable	2,587	14,225
Prepaid expenses	(5,368)	-
Accounts payable and accrued liabilities	(84,174)	74,017
Income taxes	(16,000)	(2,176)
	(136,368)	91,791
Financing:		
Loan payable	(822,000)	-
Issue of share capital	1,033,475	22,500
	211,475	22,500
Investments:		
Additions to capital assets	(975,909)	(148,436)
Proceeds on disposal of capital assets	1,207,537	-
	231,628	(148,436)
Increase (decrease) in cash	306,735	(34,145)
Cash, beginning of year	20,204	54,349
Cash, end of year	\$ 326,939	\$ 20,204

See accompanying notes to consolidated financial statements.



**Notes:  
Financial  
Statements**

**CIRCLE ENERGY INC.**

Notes to Consolidated Financial Statements

Years ended December 31, 1996 and 1995

**1. Summary of significant accounting policies:**

(a) Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its subsidiary, which were amalgamated effective January 1, 1997.

(b) Petroleum and natural gas operations:

The company follows the full cost method of accounting for petroleum and natural gas operations, whereby all costs of exploring for and developing petroleum and natural gas reserves, net of related government grants, are capitalized. Such costs include land acquisition costs, geological and geophysical costs, carrying charges on non-producing properties, costs of drilling both productive and non-productive wells, interest costs on unproved properties, and overhead charges directly relating to acquisition, exploration and development activities.

Costs of acquiring and evaluating unproved properties are initially excluded from costs subject to depletion. Unproved properties are assessed regularly to ascertain whether impairment should be added to costs subject to depletion.

Capitalized costs including the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated net proved reserves before royalties as determined by the Company's independent petroleum engineers. Petroleum and natural gas reserves and production are converted into equivalent units based upon estimated relative energy content.

Depreciation of office equipment is provided on the declining balance method at the rate of 20%. Computer equipment is depreciated on the declining balance method at a rate of 33 - 1/3%.

Total capitalized costs less accumulated depletion and depreciation, cumulative provisions for site restoration costs and deferred income taxes are limited to an amount equal to the estimated future net revenue from proved reserves (based on prices and costs at the balance sheet date) plus the cost, net of impairments, of unproved properties, less estimated future general and administrative expenses, financing costs, site restoration costs and income taxes.

Proceeds from the sale of petroleum and natural gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Future site restoration costs are provided on a unit-of-production basis. These costs are based on year end estimates of anticipated costs of site restoration. Actual restoration costs are charged to the site restoration provision as incurred.

**CIRCLE ENERGY INC.**

Notes to Consolidated Financial Statements, page 2

Years ended December 31, 1996, and 1995

**1. Summary of significant accounting policies (continued):**

(c) Joint interest operations:

A significant portion of the Company's exploration and production activities are conducted jointly with other entities and accordingly the accounts reflect only the Company's proportionate interest in such activities.

(d) Deferred financing costs:

Deferred financing costs are amortized on a straight-line basis over a two and one half year period and are included in depletion, depreciation and amortization expense.

(e) Flow-through shares:

Resource expenditure deductions for income tax purposes related to exploratory activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. The portion of the share issue price relating to the tax benefit renounced is credited to capital assets.

**2. Capital assets:**

	Cost		Net	
	1996	1995	1996	1995
Petroleum and natural gas properties	\$ 456,299	\$ 878,716	\$ 456,299	\$ 665,677
Production equipment	—	311,683	—	242,091
Office equipment	14,325	14,225	6,494	9,288
	<u>\$ 470,624</u>	<u>\$ 1,204,624</u>	<u>\$ 462,793</u>	<u>\$ 917,056</u>

Effective April 1, 1996, the Company disposed of all of its producing petroleum and natural gas properties and related production equipment for proceeds of \$1,207,537 resulting in a gain on disposal of \$393,090. Subsequently during 1996, the Company incurred costs of \$975,909 for the acquisition and exploration of petroleum and natural gas properties, of which \$459,376 were written off and \$456,299 related to unproved properties and have been excluded from depletion. Of the expenditures incurred during 1996, \$200,903 related to properties located in the United States.

**Notes:  
Financial  
Statements**

**CIRCLE ENERGY INC.**

Notes to Consolidated Financial Statements, page 3

Years ended December 31, 1996, and 1995

**3. Share capital:**

The Company's authorized share capital consists of an unlimited number of common shares without nominal or par value.

Issued and outstanding:

	Number of Shares	Consideration
Balance, December 31, 1994	9,162,000	\$ 228,400
For cash on exercise of stock options	200,000	22,500
Balance, December 31, 1995	9,362,000	250,900
For cash on public offering (i)	1,047,779	943,000
For cash on issuance of flow-through shares (ii)	150,000	82,995
For cash on exercise of stock options	88,000	11,300
Issue costs	-	(70,825)
Balance, December 31, 1996	10,647,779	\$ 1,217,370

(i) The Company completed a private placement of 1,047,779 units for proceeds of \$943,000. Each unit consists of one common share and one common share purchase warrant. Two warrants entitle the holder to acquire one common share at a price of \$1.00 per share until April 30, 1997.

(ii) The Company completed a private placement of 150,000 units for proceeds of \$150,000. Each unit consists of one flow-through share and one common share purchase warrant. Two warrants entitle the holder to acquire one flow-through share at a price of \$1.20 per share until April 30, 1997.

At December 31, 1996, options for the purchase of 1,053,000 common shares (1995 - 731,000) were outstanding at exercise prices ranging between \$0.10 and \$0.52 per share, exercisable at various dates through to November 2001.



**Notes:  
Financial  
Statements**

**CIRCLE ENERGY INC.**

Notes to Consolidated Financial Statements, page 4

Years ended December 31, 1996, and 1995

**4. Income taxes:**

The income tax provision differs from the income taxes which would result had the Company applied the statutory rate of 46.12% (1995 - 45.84%) to loss before income taxes. The differences between expected and actual tax provisions are as follows:

	1996	1995
Loss before income taxes	\$ (149,387)	\$ (161,281)
Expected income tax expense	(68,897)	(73,931)
Increase (decrease) in income tax expense resulting from:		
Non-deductible crown charges	32,640	130,406
Resource allowance	-	(33,617)
Depletion not deductible for income tax purposes	-	7,776
Other	-	1,366
Unrecognized income tax benefits	18,849	-
Actual income tax expense	\$ (17,408)	\$ 32,000

**5. Loss and funds from operations per common share:**

	1996	1995
Loss	\$ (0.01)	\$ (0.02)
Funds from operations	\$ 0.00	\$ 0.00

Per share information is calculated using the weighted average number of shares outstanding of 10,238,165 for the year ended December 31, 1996 (1995 - 9,237,890).

**6. Commitments:**

The Company is committed to payments under operating leases for equipment and building through 2001 in the amount of approximately \$214,165. Annual payments are:

1997	\$ 41,300
1998	48,060
1999	43,685
2000	40,560
2001	40,560

## Corporate Information

Circle Energy Inc. is a public company trading on the Alberta Stock Exchange (CEN).

### Officers and Directors

**C.W. (Bill) Baker**  
President, CEO & Director

**H.T. (Tom) Irwin**  
Vice President, CFO,  
Secretary/Treasurer and  
Director

**Ty Pfeifer**  
Vice President of Business  
Development

**Gordon Robinson, PEng**  
Vice President, Engineering

**Kirk Henderson, CA**  
Director

**Richard DeGroat, LLB**  
Director

**Dr. Glenn Brown, PhD**  
Director

**Gary Bosgoed, PEng**  
Director

### Head Office

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Fax: (403) 777-1930

Email: [cen@circle-energy.com](mailto:cen@circle-energy.com)

Website: [www.circle-energy.com](http://www.circle-energy.com)

### Auditors

KPMG

### Solicitors

Burstall Ward

### Bankers

Royal Bank of Canada

### Registrar & Transfer Agent

Montreal Trust



**Circle Energy Inc.**

**1996 Annual Report**